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Ukraine

HRI Food Service Sector

Development

2007

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Report Highlights:

The once non-existent HRI sector in Ukraine is now vibrant and growing with over 20,000 businesses operating in the country by 2007. The majority of Ukrainian restaurants and cafeterias are newly established facilities, while most hotels in operation today opened back in the Soviet era. U.S. processed food products have a minor presence in the Ukrainian HRI market due to prohibitively high import tariffs and consumers' conservative habits. U.S. ingredients are in demand by the Ukrainian processing industry, supplying the majority of products to the HRI sector. Some high value added U.S. products can be found in upper scale restaurants and institutions.

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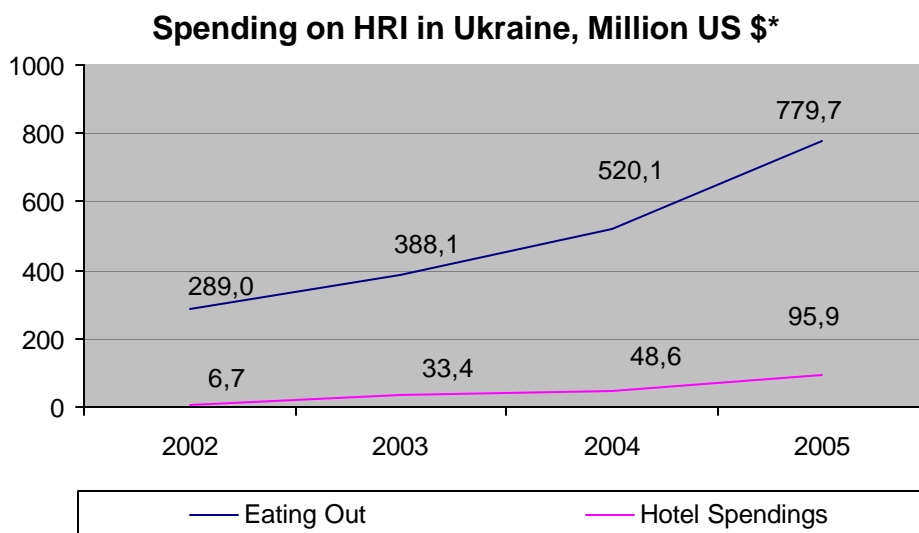
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SECTION I. MARKET SUMMARY

The number of hotels and restaurants in Ukraine has grown quickly over the past 5 years, reaching 20,580 by the end of 2006. A rapid increase in income growth over the past few years has allowed more, lower to middle class consumers to eat out. This trend is the driving force behind the rapid expansion of the foodservice industry. The Ukrainian food service sector continues to be dominated by individual (stand-alone) cafés, bars and restaurants, although development of national pizza chains, national and multinational fast food and coffee shop chains are expected to reshape the market in the next 3 to 5 years. A small, but quickly developing and lucrative market segment represented by discos, nightclubs, karaoke bars, bowling alleys and children's entertainment centers provides another outlet for imported food products. The hotel network in Ukraine is underdeveloped despite significant investments made in recent years, both by national and foreign investors. International brands have very little representation in the country. Demand for food in schools, hospitals, corporate cafeterias and fast food restaurants are price driven and provide little sales potential for imported product.

The economic hardships of the 1990's and the legacy caused by the deficiencies of the Soviet public foodservice system drove consumers to not eat out. The economic recovery that began in 1999 resulted in an increase in disposable incomes, the creation of a middle class who had pent up demand for dining out. Also, low incomes resulted in the significant growth of cheap fast food restaurants, coffee shops and pizzerias (currently the fastest growing sector) with full-service restaurants, clubs, ethnic cuisine restaurants and bars taking the lead. Ukrainian consumers are very perceptive to the western lifestyle and began socializing in cafés and restaurants. This trend quickly became part of the normal business and leisure cultures. For these reasons, Ukrainian customers rarely take food home and prefer to enjoy a meal out on the town. The younger generation (35 and younger) has become the major driving force behind the growth of the HRI sector. Ukrainians will continue to spend more on eating out.



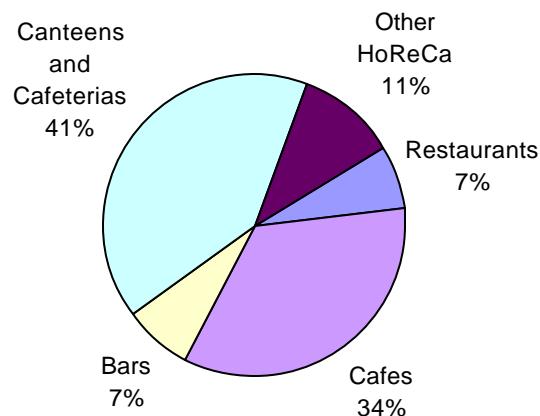
*Source: Households Spending Survey 2002-2005, State Statistics Committee of Ukraine (2002 data was collected using different methodologies).

Industry experts are predicting a 30% annual growth rate until 2009. The growth rate is only expected to slow after that point. The expansion in this sector will continue to be concentrated in cities and larger towns, where per capita incomes are higher, life more hectic, time viewed as valuable, and more consumers willing to eat out.

Restaurants and Institutional

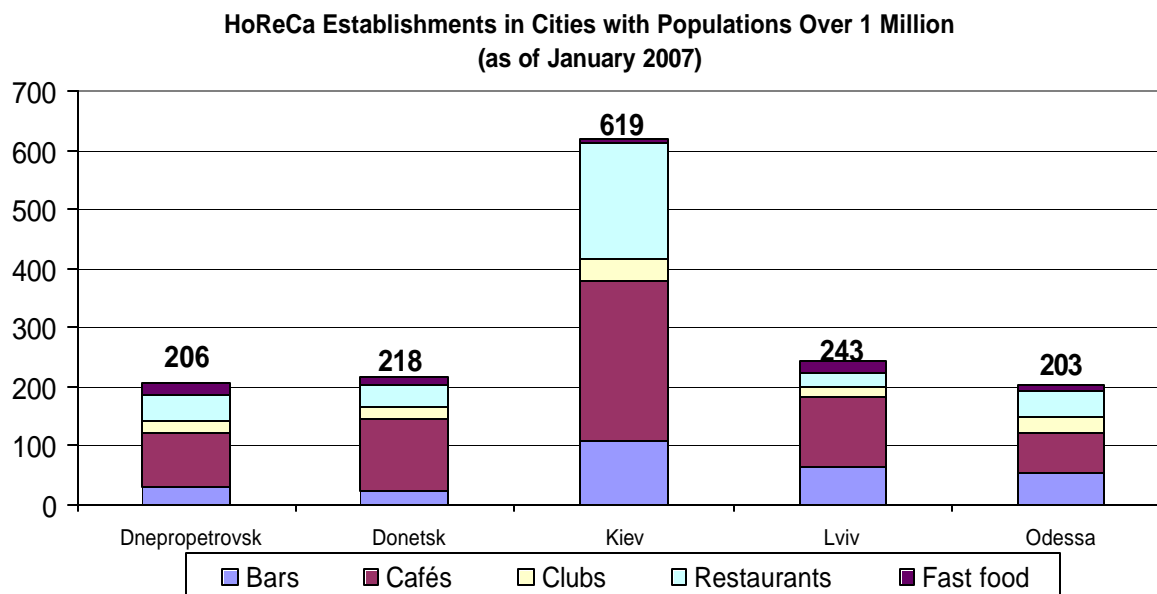
In this chapter, restaurants and institutional establishments will be analyzed. Restaurants are defined as the following food service providers: full service (upscale) restaurants, fast-food restaurants, cafés (coffee shops), pizzerias, bars, clubs, discos, karaoke bars, etc. For Institutional food service providers, the following are included: schools, hospitals and enterprise/factory canteens and cafeterias. The following graph provides the breakdown in spending for all these establishments.

Population Spendings by Different HoReCa Channels (as of 2005 - \$ 816 million)



Source: Household Consumption Survey(2005); State Statistics Committee of Ukraine
(Note: Spending includes tipping, purchasing food for home delivery/consumption, eating in theatres, stadiums etc. as well as vending machines.)

When data from the 2005 Household Consumption Survey is compared to previous surveys, the trend is clear, Ukraine's population is spending more on hotels, restaurant and cafeteria (HoReCa) establishments. The share of factory canteens and cafeterias are on the decline (6% decrease over the past 3 years) while the share of independent cafeterias and restaurants continues to increase (5% and 2%, respectively, over the past 3 years). This reflects income growth for mid-class consumers and a gradual shift from low-cost, low-quality foodservice providers to higher quality ones.



Source: Independent Consulting Company

Currently, independent establishments dominate the Ukrainian foodservice market with the exception of fast food restaurants, pizzerias and coffee shops. The overall presence of international food chains remains very limited (including McDonalds fast food, and Nestlé and Jacobs cafés). The Ukrainian fast food sector and pizza chains are developing quickly (for both corporate and franchised establishments). Chelentano Pizza (the owners also control Kartopliana Hata, Café Punkt and Yuppie networks) is leading the pack with 75 pizzerias (all franchised except for 13) all over the Ukraine. There are many newly introduced networks at different stages of development (franchising), which are slowly moving into the middle-class and even into the high-end restaurant segment (especially ethnic or specialized food establishments). The cheaper street hot-dog stalls and kiosks are slowly being removed from larger cities and moving to provincial towns with less prosperous and less demanding consumers.

Many Ukrainian fast food restaurants and chains avoid associating with “fast food”, preferring to be called “fast service restaurants”. This is a result of the negative perception that fast food chains have in the Ukrainian society (Please refer to Picture 1 in the Attachment). In public statements, managers underline their devotion to freshly procured products and a rejection of semi-processed food ingredients and fried food. Potential U.S. suppliers should be aware of that recent trend for healthier fast foods.

The high-end foodservice segment is represented by full-service independent restaurants and two large restaurant groups: The Royal Card and The World Map. These groups are independent businesses, but use a single food procurement and distribution center, as well as common discount programs. Many of the independent full-service restaurants began operations in the mid-1990’s, targeting the affluent business clientele who could spend in excess of \$100 per person per meal. The emerging middle class is still not too numerous so growth in high-end restaurant segment is insignificant when compared to fast-food establishments.

The presence of specialized coffee shops is also expanding quickly. Just a couple of years ago, the Ukrainian market boasted only a few high-end establishments that had opened in the mid 1990’s. Currently, lower-end coffee shops dominate the market. International

names such as Nestle (Nestle Ukraine S.A.) and Jacobs (Craft Foods franchising), and Ukrainian establishments such as Galka and Coffee House lead the group. More newcomers are continuing to open small outlets all over the country offering coffee, pastries and soft drinks. These establishments target students, small business employees and younger office workers. Some have copied elements from Starbucks, but others have developed their own style and menus (e.g.: Coffee House Ltd.). The market remains highly fragmented, but very vibrant and expanding quickly.

Relatively new to Ukraine, pubs, bars, nightclubs, discos, casinos, karaoke bars and other similar establishments usually serve more alcoholic drinks than food (although some clubs and casinos have in-house high-end restaurants). This sector has very limited access to U.S. food suppliers (as well as the majority of other foodservice sectors) due to very high fragmentation.

Schools, hospitals, state penitentiaries and other government institutions have their own procurement guidelines for food products. In the vast majority of cases, these organizations are under-funded and cannot be considered reliable partners. Concomitantly, the old Soviet procurement system is slowly being replaced with a more transparent system. State institutions announce open tenders for procurement of food products on their official web sites and publish them in the printed mass media. U.S. companies can compete for those orders, although quite often they are small, very product specific (certain fresh vegetables or canned meat that conforms to GOSTs and DSTUs (State Standards) and include only basic bulk products that are designed for local agricultural producers and farmers.

The general outlook for the restaurant and institutional sectors are good with positive growth projected for the next 5 to 10 years. Continued income growth will continue to drive expansion of the sector, especially outside of urbanized areas. The state institutional sector will eventually become a significant consumer as budget constraints relax and procurement transparency increases. So far, U.S. suppliers may only directly approach established restaurant chains (both fast food and hi-end) that use common distribution centers for ingredients procurement. For the remaining portion of the industry, contact through importers is advised.

Income and overall economic growth are the determining factors behind the development of the foodservice sector (please refer to Table 2 in the Attachment). Income growth exceeds GDP growth (please refer to Table 1 in the Attachment) and almost tripled between 2000 and 2005. Experts predict that the foodservice sector's growth rate will mirror the increase in incomes, which is growing between 20 to 30 percent per year. Future growth is expected in smaller towns where people are able to afford eating out.

Table. Ukraine's Income Growth (\$ million)

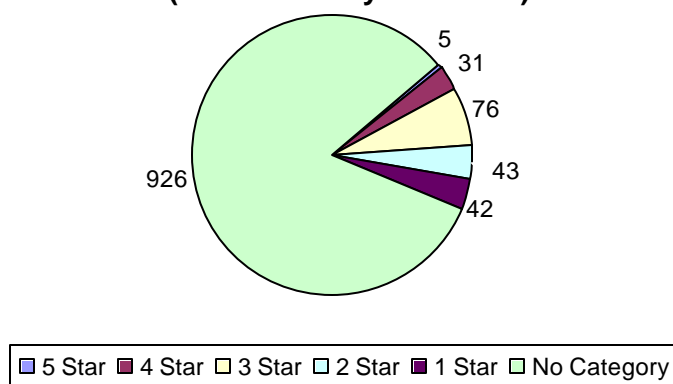
	2001	2002	2003	2004	2005
Incomes, Total	29,410	34,745	40,443	51,557	74,425
including:					
Salaries	12,544	14,822	17,741	22,038	31,343
Profit from businesses and miscellaneous incomes	5,495	6,297	6,813	8,240	11,397
Property Income	796	994	1,258	1,567	2,161
Social Transfers	10,576	12,632	14,632	19,711	29,525

Hotels and Resorts

The hotel and resort sectors are the least developed in Ukraine. Non-transparent legislation including fuzzy property rights and distribution of land plots for construction, a lengthy return on investment, and high risk has hindered investment from flowing into this sector. Thus far there are only four 5-star hotels in Ukraine. A 5th is under accreditation. The vast majority of 3-star to “no category” hotels are old soviet hotels with poor service standards and pricing policies. Hotels are used mostly by businessmen and rarely by tourists. Ukrainians prefer to stay in private apartments while vacationing (See spending structure by hotel type bellow). Conditions in private apartments are often better than in nearby “no category” hotels. These cheap private apartments are especially popular among vacationers traveling to sea resorts in Crimea and Southern Ukraine as well as skiers going to the Carpathian mountains. The lack of reasonably priced hotels in Kyiv has resulted in the formation of an entirely new category of hotel, or apartments for rent. Clients may rent a completely renovated 2-bedroom apartment in the center of Kyiv for \$100 a night, while few overbooked 4-star and 5-star hotels offer a regular-size room for \$170 to \$376.

Large western hotel chains find penetration in the Ukraine market difficult. Only Swedish Radisson-SAS has opened a single 4-star hotel in Kyiv and announced a plan to build one more hotel in the near future. Hilton Hotels is developing a hotel in the center of Kyiv as well as Hyatt Regency. The Hyatt is expected to open its doors by the end of 2007. Access to these hotels can be obtained through their international offices, but sales of food products will not be substantial.

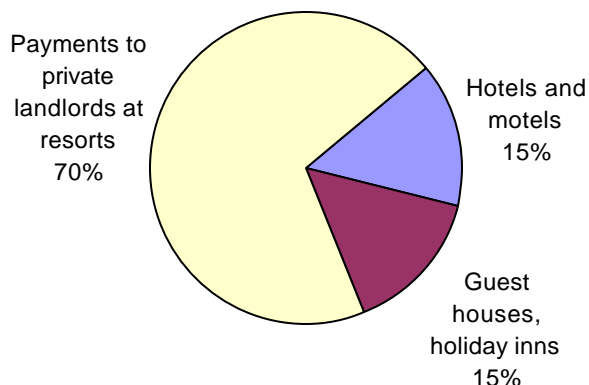
**Number of Certified Hotels in Ukraine
(as of February 15th 2007)**



Source: State Service for Tourism and Resorts

According to official statistics, Ukraine has over 4,500 hotels and resorts with a total capacity of 620,000 visitors. It is unclear how many of these are still operational. The State Service for Tourism and Resorts estimate a much smaller number of operational hotels (1,123) and resorts.

**Spending by Hotel Type
(as of 2005 - \$ 95.9 million)**

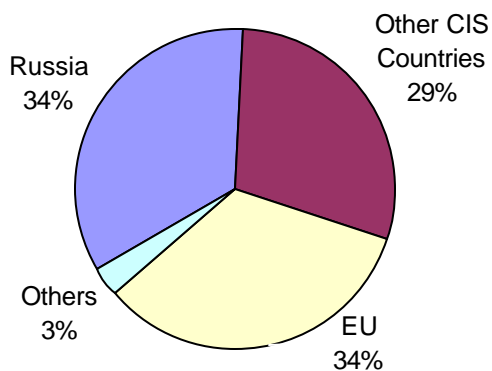


Source: Household Consumption Survey (2005); State Statistics Committee of Ukraine

The number of visitors to the country continues to increase. The increase in tourists from the European Union is expanding the most rapidly (mainly from Poland and Hungary), but they rarely visit other regions other than Kyiv, Crimea and Western Ukraine. However, the vast majority of visitors continue to be from Russia and Former Soviet Union (FSU) countries. Given relatively low per capita incomes in these countries, spending for lower cost accommodations will continue.

These tourists travel to Ukraine "as cheaply as possible" and generally are interested in leisure vacations by the Black Sea or around the Carpathian mountains. In order to cut costs they often stay in private rooms or apartments rented out by the locals. This custom is changing slowly and the share of hotels and guesthouses is growing as incomes in FSU countries grow. However, wealthier Russians have changed their vacation destinations from Ukraine to Turkey, Croatia or Bulgaria to take advantage of the more developed hospitality industry.

**Visitors to Ukraine in 2006
(Total 18.9 million)**



Advantages and Problems for U.S. Exporters

Advantages	Problems
Population of 46.8 million. A growing number of consumers who can afford to purchase high-quality food products	Despite general income growth, majority of consumers continue to save money on food or rely on home produced food products
Demand for higher quality food products is growing especially in high-end establishments	Many customers have a prejudice against imported food products due to the boom of low-quality food product imports in the early 1990's.
Ukraine's HRI sector is expanding, which creates a number of opportunities to perspective U.S. exporters.	Frequently changing trade legislation and policies often impact trade. Import tariffs remain very high.
Changes in urban life-styles has increase demand for eating out	Rapid development of local manufacturers producing ready-to-cook products creates competition for similar imported goods
American-made food and drinks are still new for the majority of the population, but rather popular among the younger generation;	Growing number of domestically produced generic products; lack of knowledge towards American products
In general restaurant owners are opened to new products in order to attract customers	Strong competition with suppliers of similar products from Russia and European Union
Existence of large importers experienced in importing food products to Ukraine	High corruption, difficulties in finding a reliable partner or distributor

SECTION II. ROADMAP FOR MARKET ENTRY**A. Entry Strategy**

Every company must choose its own market-entry strategy that is dependant on preliminary market research results and the type of product to be promoted. The strategy is also dependant on the company's financial strength. Access to the entire HRI sector can be obtained by working through food ingredients importers, since very few chains have their own procurement centers.

- A perspective entrant is advised to analyze market competitiveness for a specific product with respect to local preferences, restaurant chain menus, local competition and sales channels (marketing research from a specialized consulting firm may be required).
- A visit to a restaurant or food exhibition in Ukraine may be very useful. These events (although many of them are dedicated to HoReCa equipment) can provide a market snapshot, as well as to identify perspective importers and wholesale vendors. Usually only large companies participate in these exhibitions.
- It's advised to meet with representatives from state regulatory bodies in order to obtain additional information on import requirements. Companies are advised to use services provided by their embassies, consultants and foreign partners already doing business in Ukraine.
- In order to make the first delivery, usually a large local import company or chain is chosen. The company has to have a good reputation and experience in customs clearance, and must have storage facilities and a developed distribution network. The company should have an established record working with Western suppliers and experience in arranging regular supplies of food products. Western companies that strive to supply directly, circumventing Ukrainian mediators, often sustain losses due

to lack of local market knowledge. A large domestic import company is usually better adjusted to local conditions, with established trade ties and contacts in state structures. Ukraine remains a country where personal contacts play an important role in business.

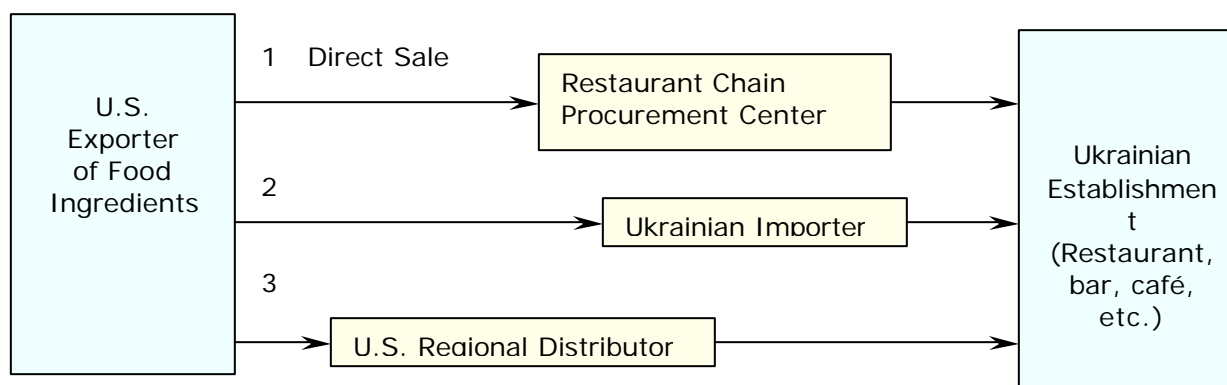
- Should an exporting company decide to open a representative office, it should be located in Kyiv, where government authorities are concentrated or in other large cities.
- Ukrainian import duty rates for food products are very uneven. Import duties for unprocessed goods or goods in large packages are often zero. Often these commodities require only minimal processing (frying, adding salt, packaging for retail trade). Duties for packaged and ready for sale products are quite high. Many companies test the market with finished products, and then look to process and package locally if the product is a success. This way they manage to reduce custom clearance costs. Many importers package tea, muesli, chocolates, chips, roast nuts and coffee beans in Ukraine. Packaging or production is often conducted in Russia or other Commonwealth of Independent States (CIS) countries. The commodity can be imported from these countries under Free Trade Agreements (FTA). FTAs are in place for 11 CIS countries. However, a potential importer should weight transportation and certification costs.

B. Market Structure

The Food Ingredients Distribution Chart summarizes all of the above. The majority of sales go through the 2nd channel, or through a Ukrainian distributor. FAS Kyiv is unaware of any direct sales of U.S. products to restaurant chains or independent establishments, although sales of high-quality U.S. beef to Ukrainian stake restaurants were recorded in the past.

The U.S. Embassy in Kyiv strongly advises that all U.S. companies consider legal counsel before and while doing business in Ukraine. Ukrainian laws and regulations are vague and open to interpretation, providing ample corruption opportunities for officials at every bureaucratic level. U.S. businesspersons are advised that partnership with a Ukrainian company is a challenge that is beyond the control of the U.S. partner and his legal advisors.

HRI Ingredients Distribution



C. Company Profiles

Almost all Ukrainian HRI sector companies are independent entities privatized during the first Ukrainian privatization campaign in 1994 through 1998. This includes restaurants of all types, coffee shops, casinos, bars, clubs, etc. Needless to say, such a large HRI sector is composed of many different types of businesses. Meals provided at work through company-

based canteens and cafeterias are often considered a part of the employee's compensation package (or social package). These facilities often operate as an auxiliary enterprise (often at a loss for the parental company, or with zero profit). Over time this sector is expected to shrink substantially. The state continues to control most institutional organizations such as hospitals, schools, railways and prisons. Privatization of food service in these organizations is not expected and will remain unchanged for the foreseeable future. Access to this sector is possible only through participation in open tenders.

Table 9. Major Ukrainian HRI Companies and Chains

Company Name	Outlet Name, Type and Number of Outlets	Location	Purchasing Agent
Fast Food Systems (FFS)	Chelentano Pizza - 72 Kartopliana Hata - 27 Café Punkt- 2 Yuppie - 3	Nationwide	Own Distribution Center for franchisees
McDonalds Ukraine Inc.	McDonalds - 57	Nationwide	Direct Importer (does not work with franchisees in Ukraine)
Royal Card	Over 60 (Virtual Franchising Network) + Catering Service	Nationwide + 5 restaurants in New York (USA)	Direct, Own Distribution Center
World Map	20 (Virtual Franchising Network) + Crystal Catering Service	Retail and HRI	Direct, Own Distribution Center
Eurohata	Fast food restaurants - 11	Kyiv and Zaporizhia	N/A
Mack Smack Ukraine	Mack Smack Pizzeria -12 Mr. Snack - 16	Nationwide	Direct Importer
Pechena Kartoplia Ltd	Pechena Cartoplia 40	Nationwide	Direct, Own Distribution Center for franchisees
Omex Inc.	Two gees -12	Nationwide	Direct, Own Distribution Center
XXI Century	Shvydko - 11	Kyiv	Direct Importer
Puzata Hata	Puzata Hata - 4	Kyiv	Works with Importers
Taste Factory	20 (Virtual Franchising Network) -5	Kyiv	Works with Importers
Rosinter Ukraine	Restaurants, Pizzerias -4	Kyiv	N/a
Carte Blanche	Upscale Restaurants (Virtual Franchising Network) -5	Kyiv	N/a
Kraft Foods Inc	Jacobs Coffee Shop - 5	Nationwide	Direct, Own Distribution Center
Nestle Ukraine	Nestle Coffee Shop - 6	Kyiv	Direct, Own Distribution Center
JV Galka	Galka Coffee Shop - 6	Western Ukraine	Direct, Own Distribution Center
Love and Hunger (former Eric's Family)	Bars, Clubs and Restaurants - 8	Kyiv	Direct, Own Distribution Center
Coffee House	Coffee House - 10	Kyiv	Direct, Own Distribution Center
Coffee Time	Coffee Time - 5	Kyiv	Direct, Own Distribution Center
Trali-Vali	Trali-Vali -3	Kyiv	Own Distribution Center

Source: FAS Kyiv Estimate;
Estimated sales are unavailable

Section III. Competition

More than 95% of all food products consumed in Ukraine are produced domestically. Current domestic production and consumption of agricultural and food products in Ukraine is still only half the level recorded during the last years of the Soviet era. The seafood, fruits and vegetables, and beverage sectors have developed very quickly over the past 5 years. Production of meat, fats, and dairy is on the decline. According to the World Bank Country Classification, Ukraine belongs in the group of low-income countries. The average Ukrainian family continues to spend a significant share of their income on purchasing food products. In 2006, the share of food product expenditures in the Consumer Price Index consumption basket reached almost 70%.

Products from the European Union are the main competitors for U.S. products. CIS countries cannot compete with European and U.S. producers in high value added and processed products, but are quite successful in supplying cheap food products. Currently, over 30% of products (both processed and raw materials) are imported from the EU, and almost 19% from CIS. Germany, Netherlands, France and Italy are the main suppliers of food ingredients to Ukraine. As consumer preferences shift to more expensive products, more opportunities will develop for U.S. and European companies at the expense of CIS products.

Competitive Situation in the Ukrainian Food Ingredients Market

Product Category	Major Supply Sources in 2005**	Strengths of Major Supplying Countries	Advantages and Disadvantages of Local Suppliers
Poultry meat* Net imports: 141.7 TMT U.S.\$ 27.9 mil (CIF) in 2005	1. U.S. – 52% 2. Brazil – 6% 3. UK – 6% 4. Belgium – 5% 5. Germany – 8%	European suppliers are price competitive and do not use chemicals, that cause concern from the Ukrainian Veterinarian Service. Brazilian poultry supplies began in 2003, but are not price competitive since the lifting of the poultry ban in 2003.	Quickly developing domestic suppliers are increasing their market share. The use of technology has advanced greatly over the past 5 years.
Nuts Edible Net imports: 7.8 TMT U.S.\$ 3.5 mil (CIF)	1. U.S. – 14% 2. Azerbaijan – 17% 3. Turkey – 59% 4. Iran - 6%	U.S. competitors supply hazelnuts, pistachio, and walnuts, leaving almonds to U.S. suppliers. Most competitors are located in close proximity to Ukraine (mostly the Black sea region) and offer good deals for price cautious Ukrainian buyers.	There is no nut production in Ukraine. Insignificant quantities of walnuts come to the market from natural forests.
Fish and fish products Net imports: 370 TMT U.S.\$ 13.7mil (CIF)	1. U.S. – 6% 2. Norway – 45% 3. Estonia – 3% 4. Canada – 4% 5. Iceland - 5% 6. Russia – 6%	U.S. share of Ukrainian market is quickly growing while market share of traditional exporters (Estonia and CIS countries) shrinks. Norway promotes its products very aggressively, investing in processing and cold storages. The Russian share is stable and surprisingly low.	Local production is limited to fresh water fish and Black sea basin fish. Atlantic fish quotas for Ukraine are small. Popular fish species are not supplied by local fishermen and have to be imported.

Source: State Customs Committee, FAS Kyiv Calculations.

* *Poultry ban (introduced in 2002 and lifted in late 2003) had a long-term negative impact on trade.*

** *In value*

SECTION IV. BEST PRODUCT PROSPECTS

A. Best Product Prospects with Good Sales Potential

The following import sectors are the most developed and most likely to grow in the short term:

- Poultry meat (where U.S. products dominate) will continue to be a major U.S. export commodity for the next 3-4 years if no obstacles are imposed. It is likely that local producers of chilled and frozen poultry will be able to expand production and increase their market share. The size of the market is estimated at \$255 million and growing, with local producers capable of satisfying only one half of the demand;
- The seafood products market is developing very rapidly. Record high U.S. exports were recorded beginning in 2004 and the market continues to grow at an astounding rate. Insignificant domestic production of low quality products will continue to open the door to imports. The annual consumption of fish and fish products in Ukraine has reached 702 MT in 2006 with a possible growth to 900 MT by 2010.
- Beef and pork offal for further processing (predominately beef liver and tongs) looks very promising. Exports of beef from the U.S. were resumed in 2007 after removal of veterinary technical barriers to trade and the signing of a protocol in March 2006. Upon Ukraine's accession to the WTO (expected in the end of 2007), other meat products will be competitive and demanded in the Ukrainian market
- Almond imports are growing due to the booming Ukrainian confectionary industry. The market for almonds is expected to grow in 2007, and the market will continue to be sizable and attractive to American businesses.

SECTION V. POST CONTACT AND FURTHER INFORMATION

Should you have any questions about this report or need assistance, please do not hesitate to contact the Agricultural Affairs Office in Kyiv at the following Address:

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Homepage: http://Kyiv.usembassy.gov/fasKyiv_index_eng.html

A list of importers is available from FAS Kyiv to exporters of U.S. food products. The Country Commercial Guide, prepared by U.S. Foreign Commercial Service is available at http://www.buyusainfo.net/body2.cfm?dbf=ccg1&search_type2=int&country=Ukraine&logic=and&loadnav=no

For the most recent "Exporter Guide" and product briefs please visit USDA's Foreign Agricultural Service official website at www.fas.usda.gov.

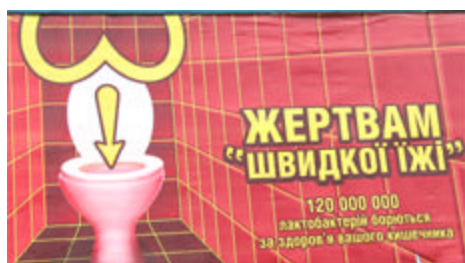
Attachments

Table 1. Consumer Foodservice Network (including Joint Stock Companies and Private Entrepreneurs)

	Total Number	Entities ('1000)		Share	
		Companies	Private Entrepreneurs	Companies	Private Entrepreneurs
Restaurants	1,9	1,2	0,7	65,2	34,8
Cafes (stalls, snack bars etc)	34,1	12,6	21,5	37,0	63,0
Bars	9,0	2,9	6,1	31,9	68,1
Canteens	11,5	10,5	1,0	91,2	8,8
Ready to eat food suppliers	0,1	0,1	-	100,0	-

Table 2. Ukraine's Selected GDP indicators

Years	In real terms		% to previous year		Deflator Index (to previous year)
	GDP	GDP/per person	GDP	GDP/per person	
	\$million	\$			
1998	33280	651	98,1	98,8	112,1
1999	22604	446	99,8	100,6	127,3
2000	18858	375	105,9	106,7	123,1
2001	24281	487	109,2	111,1	109,9
2002	31928	645	105,2	106,3	105,1
2003	38290	787	109,6	110,5	108
2004	42452	881	112,1	113,0	115,1
2005	52168	1091	102,6	103,4	119,9

Picture 1. An advertising campaign against fast food restaurants launched by a Ukrainian Drug Suppliers (billboard photo)

The slogan reads: To the victims of fast food; 120 000 000 lacto-bacteria fight for the health of your guts